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SUBJECT: HK BUSINESSES WARN TREASURY CONFIDENT CHINESE
BOOSTING ASIAN TIES

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Classified By: Acting Consul General Christopher Marut, Reason 1.4 b/d

¶1. (C) Begin Summary: Treasury Senior Coordinator for China and the U.S.- China Strategic and Economic Dialogue (S&ED) David Loevinger led a Treasury and Consulate General team in meetings with Blackstone Asia Chairman Anthony Leung, Credit Suisse Asia CEO Kai Nargolwala, Hong Kong Monetary Authority (HKMA) Chief Executive Norman Chan and Hong Kong Financial Services and Treasury Bureau (FSTB) Undersecretary Julia Leung on January 28 to discuss recent Chinese economic developments, U.S.-China relations, and China's efforts to build stronger ties in Asia, including the internationalization of the Chinese Yuan.

¶2. (C) Summary Continued: Blackstone's Leung and Credit Suisse's Nargolwala warned visiting officials that the global financial crisis and slow U.S. recovery had badly damaged America's economic leadership in Asia. Our interlocutors were concerned about increasingly obvious friction in the U.S.-China relationship, and remarked on China's rising assertiveness in light of the country's continued growth and positive role in the global recovery. They saw strengthened regional economic relationships and continuing developments in the internationalization of the renminbi (RMB) as part of a Chinese strategy to shift trade and investment away from Western countries to more friendly regimes in Asia. End summary.

¶3. (C) Comment: The uncertainty inherent in U.S. financial and regulatory reforms was of greater concern for our private sector contacts than developments in China. Despite the concerns raised by our private sector interlocutors, we see little evidence that Chinese authorities are actively discouraging investment in or trade with the West, though perceived barriers to Chinese investment in the U.S. undoubtedly push some of these firms to look for opportunities in Asia. Expanding trade ties and increased use of the RMB in the region, combined with local worries about U.S. protectionism, are likely to promote even closer economic relations between China and the rest of Asia. End Comment.

Chinese Confidence Changing the Game

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¶4. (C) Both public and private interlocutors agreed that growing Chinese confidence and economic nationalism were encouraging PRC leaders to take more aggressive international positions. Blackstone's Anthony Leung warned that trade friction had the potential to derail the U.S.-China relationship. Though the Chinese needed both U.S. markets to

support their export-led economy and U.S. military power to guarantee stability in the region, Chinese leaders were becoming more confident and seemed increasingly likely to respond to a growing populist nationalism that encouraged an aggressive international posture. FSTB's Julia Leung agreed that Chinese leaders were becoming both more assertive abroad and more attuned to protectionist pressures at home. Anthony Leung noted that some influential Hong Kong business leaders were publicly calling for Asia to reject western, and by extension, U.S. leadership. He noted that Japan was often cited as an example of what could happen when countries bend to Western pressure to allow their currencies to appreciate, and suggested that China would be unlikely to make the same mistake.

¶ 5. (C) U.S. financial firms in particular were facing Chinese reluctance to engage with foreign firms, said Blackstone's Leung. He complained that Blackstone was investing RMB in China, but was unable to raise funds in China due to their inability to get needed approvals from the National Development and Reform Commission (NDRC). He suggested this was at least partly a reflection of Chinese efforts to develop and protect their own financial services companies. The Chinese were eager to develop their own financial infrastructure in order to present an alternative in global discussions of financial architecture and regulatory reform. He acknowledged that private equity firms saw some prospects for liberalization, including the possibility of raising RMB funds in China. Leung also suggested that a proposal to approve Qualified Foreign Limited Partnerships, ostensibly modeled on the Qualified Foreign Institutional Investor (QFII) framework, was under consideration by Chinese regulators. This would make it

easier for foreign firms to raise RMB funds for investment in China, he said.

U.S. Image Bruised; Asians Strengthening Regional Ties

¶ 6. (C) Chinese leaders were cultivating Asian partners by promoting trade and investment in Southeast Asia and India and were actively discouraging business in the West, where they may face increased regulatory or security-related scrutiny, said Nargolwala. Although the U.S. still had considerable influence in the region, security reviews that made it difficult for some travelers to obtain U.S. visas and high profile CFIUS-related cases had damaged America's reputation in Asia for openness. Following the financial crisis, Asians' tolerance for being lectured by the West had markedly declined, he said. Though the Chinese wanted to avoid the responsibility of leading an Asian bloc in international economic fora, they seemed comfortable acting as a balance between the U.S., European Union and the developing world. Asian countries recognized that any "Asian" position was untenable without Chinese support, and appeared to be building stronger relationships with China, which was in a position to advocate for regional interests, he said. Nargolwala also opined that RMB internationalization was part of a Chinese strategy to more closely tie regional economies to China.

¶ 7. (C) FSTB's Leung acknowledged that Chinese firms were looking for opportunities to expand into Hong Kong and the region, and noted that a Chinese firm recently purchased a Hong Kong broker-dealer, perhaps laying the groundwork for additional Chinese financial activity in Hong Kong. RMB internationalization in Hong Kong was moving even faster than expected, she said. Measures to allow Chinese firms to use RMB to purchase Hong Kong-based companies could be in place soon. RMB settlement for trade in services and extending RMB trade settlement to third countries could also be in the works this year, according to Leung.

Chinese Economy Looking Strong

¶ 8. (C) Julia Leung was optimistic about the prospects for

the Chinese economy in 2010. Asset bubbles in some sectors of the Chinese real estate market were growing, but currently seemed manageable, she said. Overall, the risks to the Chinese economy were low, but inflationary pressures on the horizon would likely lead China to tighten access to credit. HKMA's Norman Chan agreed and noted that China was already using administrative measures to slow loan growth. He discounted concerns about excessive loan growth in the first three weeks of January, noting that many of the bigger banks had sold loans to smaller banks late in 2009 to avoid breaching capital requirements and were now buying these back. This type of "stop-go" lending was typical in the Chinese economy and both banks and firms were used to dealing with it, said Chan.

Stay Low Key on RMB

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¶9. (C) FSTB's Leung warned against public pressure to allow the RMB to appreciate. U.S. statements on currency issues were counterproductive, she said. Blackstone's Leung agreed that currency issues were best discussed quietly. He doubted that RMB appreciation would substantively shrink the U.S.-China trade balance, but acknowledged that it could help defuse pressure for protectionist measures directed at China. He encouraged Treasury Secretary Geithner to make public statements opposing protectionism while privately encouraging Chinese leaders to allow the RMB to appreciate.

¶10. (U) Special Coordinator Loevinger's Office cleared this message.

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